NO PREP

Federal Budget & Debt

Funding the Nation's Priorities

Includes: Student reading, case study, differentiated questions, teacher key

Name: Period: Date:

Federal Budget & Debt: Funding the Nation's Priorities

Anatomy of the Federal Budget

The federal budget outlines projected revenues (individual income taxes, payroll taxes, corporate taxes, and miscellaneous receipts) and planned outlays (mandatory programs, discretionary spending, interest payments). In 2023, individual income taxes accounted for about 50% of revenues, payroll taxes 35%, corporate taxes 7%, and other receipts 8%. Outlays split into mandatory—programs like Social Security and

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Deficits vs. Debt: Key Distinctions

A budget deficit occurs when annual outlays exceed revenues. The national debt is the cumulative total of all past deficits minus surpluses. That total works much like a household's mortgage balance. Running short-term deficits can stimulate economic activity in downturns, but persistent deficits raise the debt-to-GDP ratio, potentially heightening borrowing costs. Distinguishing flow (deficit) from stock (debt) is crucial: a manageable deficit at low debt levels poses fewer risks than the same deficit when debt is already high.

Measuring Sustainability: Debt-to-GDP Ratio

The debt-to-GDP ratio gauges public debt relative to the economy's size: Debt-to-GDP = (Total Public Debt ÷ Nominal GDP) × 100%. A moderate ratio suggests debt is serviceable; a high ratio can alarm investors and lead to credit-rating downgrades. Japan's ratio exceeds 250%, yet low interest rates have kept financing costs

modest. The U.S. ratio rose above 130% post-pandemic, prompting debates on sustainability. Policymakers use this metric to decide whether to pursue spending cuts, tax hikes, or rely on growth to stabilize the ratio.

Economic Implications of Rising Debt

Large debt burdens can crowd out private investment if government borrowing pushes up interest rates. As interest payments consume a growing share of the budget, fewer resources remain for discretionary priorities. However, in low-rate environments, governments can borrow cheaply—if funds finance productive investments (infrastructure, R&D), they may pay for themselves over time. The key debate centers on balancing short-term stimulus needs against long-term fiscal sustainability.

Key Information

Outlay Category	% of Total Outlays (2023)	Description
Social Security	24	Retirement and disability benefits
Medicare & Medicaid	28	Health insurance for elderly and low-income
Defense	13	Military operations and personnel costs
Nondefense Discretionary	12	Education, transportation, housing
Interest on Debt	9	Payments to bondholders
Other Mandatory (e.g., SNAP)	14	Unemployment insurance, welfare programs

Case Study Excerpt: "The 2011 U.S. Debt Ceiling Crisis"

In mid-2011, the U.S. approached its statutory debt ceiling, the legal limit on Treasury borrowing. With projected deficits exceeding revenues, Congress faced the risk of defaulting on Social Security checks, military salaries, and interest payments. Political brinkmanship delayed action, triggering a historic credit-rating downgrade by Standard & Poor's from AAA to AA+. Global markets reacted violently: stock indices plunged over 16% in the two weeks following the downgrade warning. To avert default, the Budget Control Act of 2011 raised the ceiling by $2.1 trillion and mandated $917 billion in future spending cuts through automatic across-the-board sequestration if targeted savings weren't achieved. Though the immediate crisis passed, Treasury yields remained elevated, increasing borrowing costs. The episode forced a reevaluation of long-term fiscal trajectories and underscored how political constraints on borrowing authority can undermine investor confidence and impose real economic costs.

1. How did the debt-ceiling impasse affect U.S. Treasury yields and borrowing costs?

_____

_____

2. What mechanisms in the Budget Control Act were designed to enforce future deficit reduction?

_____

_____

Multiple Choice

1. Mandatory spending includes:

    a) Department of Education budgets

    b) Social Security benefits

    c) Highway construction grants

    d) Defense procurement

2. A high debt-to-GDP ratio can lead to:

a) Higher borrowing costs for the government

b) Increased private investment in markets

c) Lower interest rates on bonds

d) Automatic debt reduction

3. The debt ceiling legally caps:

a) Total outstanding federal debt

b) Deficit as a percentage of GDP

c) Annual budget outlays

d) Discretionary spending

Matching

Write the letter of the correct definition on the line next to each term.

Term	Definition
1. ___ Budget Surplus	A) Expenditures set by annual appropriation laws
2. ___ Sequestration	B) Payments made to bondholders
3. ___ Discretionary Spending	C) Automatic across-the-board cuts if spending targets are missed
4. ___ Interest on Debt	D) Total public debt divided by GDP
5. ___ Debt-to-GDP Ratio	E) Revenues exceed outlays in a fiscal year

Fill-in-the-Blank

1. When outlays exceed revenues, the government runs a _____.

2. _____ spending—like Social Security—adjusts automatically with eligibility rules.

3. The 2011 crisis led to automatic cuts under the _____ Control Act.

Short Answer

Answer each question in 2-4 complete sentences.

1. Explain why the debt-to-GDP ratio is a better gauge of sustainability than absolute debt.

2. Describe one advantage and one disadvantage of imposing a strict debt ceiling.

3. Summarize how entitlement reforms could improve long-term debt outlooks.